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In the Supreme Court of the United States

OCTOBER TERM, 1928

No. ——

HARRY H. WEISS, COLLECTOR OF INTERNAL REVENUE, PETITIONER

v.

J. HARRY WIENER

No. ——

C. F. ROUTZAHN, COLLECTOR OF INTERNAL REVENUE, PETITIONER

v.

J. HARRY WIENER

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT, AND BRIEF IN SUPPORT THEREOF

The Solicitor General, on behalf of Harry H. Weiss, Collector of Internal Revenue, and on behalf of C. F. Routzahn, Collector of Internal Revenue, prays that writs of certiorari issue to review the judgments of the Circuit Court of Appeals for the Sixth Circuit, entered in the above cases on the 30th day of June, 1928, reversing the judgments of the United States District Court for the Northern District of Ohio.

QUESTION PRESENTED

In the determination of his taxable net income under the Revenue Act of 1918, is the taxpayer entitled to any deduction under Section 214 (a) (8) of that Act on account of the exhaustion, wear and tear of buildings occupied by him under ninety-nine-year leases, renewable forever, where such leases were acquired after March 1, 1913, and cost the taxpayer nothing except a stipulated annual rental, and where the buildings in question were not erected or paid for by the taxpayer?

STATUTE INVOLVED

Revenue Act of 1918, c. 18, 40 Stat. 1057, 1066, 1067:

> SEC. 214. (a) That in computing net income there shall be allowed as deductions:
>
> (1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered, and including rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity;
>
> • • • • •
>
> (8) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence; • • •.

STATEMENT

These two cases were instituted by the respondent in the United States District Court for the Northern District of Ohio to recover income taxes for the years 1918, 1919, and 1920, paid under protest (R. 12, 18), and, since they both involved the same question of law, were disposed of as a single case (R. 1, 60). Judgments were entered in favor of the Government. (R. 16, 32.) The cases were taken on writs of error to the Circuit Court of Appeals, Sixth Circuit, where they were heard together. The Circuit Court of Appeals reversed the judgments of the lower court. (R. 88.)

During the years 1918, 1919, and 1920 the taxpayer was the owner of thirteen leases for ninety-nine years, renewable forever. These leases were all acquired after March 1, 1913, and the lessee paid nothing for them. At the time the leases were made, there were standing on the premises certain buildings which had been erected by and at the cost of the lessor. These buildings were sublet by the lessee to tenants, and the income thus produced was included by him in his income tax returns for the years 1918, 1919, and 1920. (R. 35.) In calculating his net income, the respondent was allowed to deduct as business expenses all sums spent as repairs on said buildings. (R. 37.)

The covenants contained in these several leases vary. In four of them (H, I, J, and L—R. 42, 43, 44, and 45) there is a covenant to keep and maintain on the premises buildings of a specified value

In all of the leases there is a provision that in case of a destruction by casualty the buildings shall be replaced. In some cases it is specifically provided that the lessee shall furnish funds in addition to the insurance money if necessary to restore the property. In other cases it is merely provided that the insurance money shall be applied to the restoration. In seven of the leases (A, B, C, E, H, I, and L—R. 37, 38, 39, 40, 42, 43, and 45) it is provided that the destruction of the buildings does not terminate the leases. In three of the leases (D, F, and G—R. 39, 41, and 42) the lessee is obligated to erect new buildings at specified costs within specified times. In five of the leases (C, E, F, H, and L—R. 39, 40, 41, 42, and 45) the lessee is given an option to purchase. Seven of the leases (D, E, F, G, J, K, and N—R. 39, 40, 41, 42, 44, and 47) were surrendered, cancelled, or assigned.

In so far as the lessee had made any expenditures for repairs, improvements, or replacements, such expenditures were taken into account in determining his taxable income. (R. 37.)

The taxpayer claims a right to deduct from his gross income in each year an aliquot part of the value at the time he acquired the lease of the buildings standing on the leased property. This, he asserts, represents the depreciation of those buildings. The Government contends that any expenditures which he makes under the leases he may deduct, but that he can not set up a reserve to liquidate his obligations, even if such obligations were fixed.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred in holding that the respondent was entitled to a deduction, under Section 214 (a) (8) of the Revenue Act of 1918, on account of the exhaustion, wear and tear of buildings occupied by him under ninety-nine year leases, renewable forever, where such leases were acquired after March 1, 1913, and cost the respondent nothing except a stipulated annual rental, and where the buildings in question were not erected or paid for by him.

REASONS FOR GRANTING THE WRITS

The Circuit Court of Appeals in reversing the judgments of the District Court and in allowing the respondent to take deductions for the exhaustion, wear and tear of buildings occupied by him under long-term leases, renewable forever, has made a new application of the provisions of the Revenue Acts relating to depreciation and has, it is believed, misconceived the meaning of Section 214 (a) (8) of the Revenue Act of 1918 under which it allowed the deductions.

The decision of the Circuit Court of Appeals is not in harmony with the decision of this Court in *United States* v. *Ludey*, 274 U. S. 295, where it was held that depreciation was a deduction from original cost (p. 303), a reduction of capital assets (p. 300), since the effect of the decision below was to allow depreciation to one who incurred no original cost and had no capital invested.

The decision of the Circuit Court of Appeals is not in harmony with the decision of this Court in

Duffy v. *Central Railroad*, 268 U. S. 55, where it was held that an expense incurred by a lessee under a long-term lease in acquiring title to an old pier and replacing it by a new one could be allowed for only by taking appropriate deductions for depreciation after the expense had been incurred.

If the decision of the Circuit Court of Appeals is allowed to stand it will require a reversal of a uniform and long-continued departmental construction of the provision of the Revenue Act of 1918 here in question and similar provisions in earlier and subsequent Acts.

The proper decision of these cases is thus a matter of wide importance in the administration of the tax statutes. The principle involved will find frequent application in connection with the taxation of public utilities where properties are often operated under long-term leases providing for the maintenance of the properties. Wherefore it is respectfully submitted that this petition for writs of certiorari to review the judgments of the Circuit Court of Appeals for the Sixth Circuit should be granted.

WILLIAM D. MITCHELL,
Solicitor General.

SEPTEMBER, 1928.

BRIEF IN SUPPORT OF PETITION

OPINIONS BELOW

The opinion of the United States District Court for the Northern District of Ohio (R. 60) is reported in 17 F. (2d) 650. The opinion of the Circuit Court of Appeals (R. 89) is reported in 27 F. (2d) 200.

JURISDICTION

The judgments of the Circuit Court of Appeals were entered on June 30, 1928. (R. 88.) The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

STATEMENT

A statement of the facts and of the errors relied on will be found in the petition.

ARGUMENT

I

DEPRECIATION IS PROPERLY ALLOWED ONLY IN CASES WHERE THE TAXPAYER HAS MADE A CAPITAL OUTLAY

It is the contention of the petitioners, relying on principles announced by this Court in *Duffy* v. *Central Railroad*, 268 U. S. 55, and *United States* v. *Ludey*, 274 U. S. 295, that an allowance for depreciation is properly made, under the provisions of Section 214 (a) (8) of the Revenue Act of 1918, only to such taxpayers as have made a capital outlay. On the other hand the taxpayer, because of the long terms covered by the leases and of certain covenants contained therein, claims the right to set up a reserve for depreciation, notwithstanding the fact that he has made no capital outlay and the further fact that his obligations under the leases are contingent and may never have to be complied with by him.

The District Court in speaking of the respondent's claimed deduction for depreciation, said (R. 62):

> • • • He is not entitled to any other or additional deduction than was given him. Inasmuch as he had no capital investment in these leases, any allowance for depreciation on buildings would be a contribution to his capital account rather than a deduction in order to prevent an inclusion of some part of his capital as income. In substance and for all practical purposes, his annual payment of rent bought only a term for one year in the several leased premises. Hence, when he is permitted to deduct the full amount of the rent paid, together with repairs and maintenance, he is made whole with respect to his net income. Any further and additional allowance by way of depreciation of invested capital would be a mere contribution.

Speaking of the contingent obligations of the taxpayer the District Court said (R. 63):

> • • • It will be time enough to consider the question of allowing depreciation, under any of the conditions above stated, when the contingency shall have happened.
>
> That such a contingency may never happen, is evidenced by the history of the leases in question, subsequent to the year 1920. It appears from the agreed statement of facts that leases D and K have been assigned to third persons with the consent of the lessor; that leases E, G, and I have been cancelled and surrendered to the lessor; and the leases N and F have been assigned or released to

> the lessor. Thus, out of thirteen leases, seven have passed out of the picture without imposing on the plaintiff the obligation to invest any capital. If he had been permitted to retain some part of the net income under the guise of a capital depreciation, he would have merely pocketed an unearned increment.

In reversing the District Court, the Circuit Court of Appeals held that depreciation, which it described as "capital which has gone into gross income" (R. 90)—

> * * * is not necessarily the capital of the holder of the legal title, who, as in this case, may be protected by the undertakings of the lessee; nor is it the capital of the mere user of the property, who may be under no obligation to make restitution. It is, it seems to us, the capital of the one who is responsible for the property—the owner or the person responsible to the owner for it—and who also uses and consumes it in his business; and that means of course that one may not have the legal title, or may not have paid anything for the property, and still have the right to this capital deduction, since he may have an equitable interest as valuable as the property itself, or may be so obligated to the holder of the legal title to maintain or restore the property that the investment becomes his own.

It is submitted that the holding of the District Court is in line with the long-continued construction of the statute by the Commissioner of Internal Revenue, while that of the Circuit Court of Appeals is

opposed thereto. The Collectors also contend that the holding of the District Court is in harmony with the holding of this Court in *Duffy* v. *Central Railroad*, *supra*, and that the holding of the Circuit Court is not.

The Circuit Court of Appeals meets the contention of the petitioners that "to permit the lessee to take this depreciation would be to enable him to accumulate a capital investment, tax free," by saying that if—

> * * * the leases should be surrendered or cancelled when the buildings first become exhausted, the depreciation fund would be consumed in restoring them, or if they should be surrendered at some later period, when the buildings had once been replaced but had not again become exhausted, the accumulation again would be required to restore them from their partially exhausted condition. (R. 91.)

But this argument does not meet the situation which would exist if the leases should be surrendered after five, ten, fifteen, or any other number of years, while the buildings are in good physical condition and needing no replacement. It seems obvious that any depreciation allowed in those years would amount to capital in the hands of the lessee which he would have accumulated tax free. The weakness of the argument of the Circuit Court of Appeals lies in its apparent assumption that the leases were bound to run at least until the first exhaustion of the buildings, whereas they might be terminated at any moment. This is shown by the fact referred to by the District Court that at the time of the trial seven of the leases

had "passed out of the picture without imposing on the plaintiff the obligation to invest any capital." (R. 63.) The remaining leases may have passed from the picture immediately thereafter. To these commanding facts the Circuit Court of Appeals gave no weight whatever.

If we suppose, as might well have been the fact, that all the leases had been surrendered at the time of the trial, how then could the Circuit Court of Appeals defend the right of the taxpayer to retain, tax free, the depreciation allowances, constituting accumulated capital, which are the subject matter around which the controversy in these cases turns? The supposed case is not different in principle from the actual cases, and the position taken by the Circuit Court of Appeals clearly appears to be erroneous.

II

CONGRESS HAS REPEATEDLY REENACTED THE PROVISION OF THE STATUTE IN QUESTION WHILE IT WAS BEING CONSTRUED BY THE DEPARTMENT AS IN THESE CASES

Beginning with the Excise Act of 1909 (Act of August 5, 1909, c. 6, 36 Stat. 11, 113) Congress provided (Sec. 38—Second) that in computing net income there should be "a reasonable allowance for depreciation of property, if any."

The Act of October 3, 1913 (c. 16, 38 Stat. 114, 167) provided (Section II–B) for the deduction of

> • • • a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business • • •.

To this the Revenue Act of 1916 (c. 463, 39 Stat. 756, 759), Section 5–Seventh, merely added the words "or trade."

The Revenue Act of 1918 (c. 18, 40 Stat. 1057, 1067), Section 214 (a) (8), the Act here in question, provided for—

> A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence.

This language was repeated in the Revenue Act of 1921 (c. 136, 42 Stat. 227, 240), Section 214 (a) (8); in the same numbered and lettered section of the Revenue Act of 1924 (c. 234, 43 Stat. 253, 270; U. S. C., Title 26, Sec. 955 (a) (8)); in the same numbered and lettered section of the Revenue Act of 1926 (c. 27, 44 Stat. 9, 27; U. S. C. App., Title 26, Sec. 955 (a) (8)); and also in Section 23 (k) of the Revenue Act of 1928 (Act of May 29, 1928).

During all these years the Treasury Department has uniformly construed this provision to mean that the capital which is to be returned to the taxpayer in depreciation allowances is the cost to the taxpayer of the depreciable property, and that where a taxpayer has incurred no capital costs he can be allowed no depreciation.

Congress is presumed to have legislated with knowledge of this executive construction of the statute, *United States* v. *Bailey*, 9 Pet. 238, 256, and this repeated reenactment of this provision amounts "to an implied legislative recognition and approval of

the executive construction of the statute." *National Lead Company* v. *United States*, 252 U. S. 140, 146.

CONCLUSION

Because of the far-reaching effect of the opinion below, because of its conflict with the uniform and long-continued Departmental construction, and because of the manifest importance of an authoritative rule for the guidance of the Treasury Department in administering the tax statutes, it is respectfully submitted that the petition for writs of certiorari should be granted.

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SEPTEMBER, 1928.

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